

Nailing Down the Financial Principles

Introduction and Disclaimer

This paper is intended to facilitate discussion of Financial Strategy issues, not to present a draft or final plan or proposal. Topics in this paper have not been formally reviewed, discussed or approved by CALFED agencies. Suggestions or approaches found in this paper are intended to illustrate only one trial approach, and are fully subject to modification or elimination prior to the development of any draft proposal for CALFED agency review.

Summary

This paper suggests a number of critical proposals relating to the Financial Principles for funding the CALFED Preferred Alternative. These proposals are summarized as follows:

- CALFED rejects the concept of damages based on past acts because it is not possible to accurately apportion the blame for the degradation of the Delta on any particular user or group, and it is destructive to the process of trying to solve the problem.
- CALFED supports instituting a charge on all water users in the Bay-Delta system, the proceeds of which would be used to fund the Common Programs including the ERP. Within the ERP, these water user funds would be used to pay the costs of providing the ERP flows. Another possible fee would be a surcharge on pesticide use by homeowners and other non-registered applicators. The proceeds from this fee would be used to help fund the ERP and/or water quality program. Other related end-user funds, such as incremental Salmon Stamp revenues, should be used as well.
- For purposes of Storage and Conveyance facilities, CALFED determines that the benefits-based principle means that the users of these facilities must pay the full cost of the facilities including interest. The 1/3 share of new storage facilities dedicated to ecosystem purposes is deemed to be mitigation for ongoing impacts of system-wide diversions and impacts, and is to be paid for from revenues of a system-wide water user charge.
- Public funding is appropriate for the planning process, but public funds spent on the actual design of specific selected facilities must be reimbursed by the contractors for those facilities, including interest.

Benefits-Based Cost Allocation

Sharing the costs of the Preferred Alternative based on the benefits to be received is the cornerstone principle of the CALFED Financial Strategy. The fundamental philosophy is that costs will be paid by the beneficiaries of the actions, as opposed to seeking payment from those who, over time, may have been responsible for causing the

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problems being experienced in the Bay Delta system. This does not preclude obligations for mitigating harmful impacts, if a direct, ongoing, cause and effect relationship can be established.

Addressing the Baseline Issue

The first issue that must be resolved is the so-called baseline issue. The essence of this issue is that water users owe some amount of reparations to the ecosystem program for damages inflicted in the past.

CALFED rejects this concept of damages based on past acts for two key reasons:

- First, it is not possible to accurately apportion the blame for the degradation of the Delta on any particular user or group. The Delta ecosystem has been affected by human activities for over 100 years, probably beginning with hydraulic mining processes in the mid-1800's. While it is true that diverting water from and above the Delta has had a detrimental impact, many other human activities have also affected the Delta, and it is impossible to prove the level of damage attributable to each. As a result, the amount on any such reparations would be arbitrary.
- Second, it is destructive to the process of trying to solve the problem. To try to place blame for past acts and to assess arbitrary amounts on water users in order to fund ecosystem restoration will lead to fighting and bickering, not to fixing the Delta or the ecosystem. CALFED agencies have determined that solving the problem is their priority; not finding out who caused it.

As a CALFED principle, the benefits-based approach means that any obligations for mitigation should be limited to ongoing direct impacts, as opposed to historical impacts. Eliminating the concept of reparations for past acts does not relieve water users from obligations relating to ongoing impacts.

Addressing the Needs of Environmental Interests

The next issue to resolve is how to satisfy the legitimate needs of those who have been seeking reparations from the water users for ecosystem restoration. While seeking retribution for past acts is not considered a legitimate need, two legitimate needs relating to this issue have been expressed:

- Funding for the ecosystem restoration program must be adequate to enable its successful implementation. The funding concern relates to the unpredictable and limited nature of public funding sources. If the ERP were to be paid for using only public funds, that could subject it to a continuing struggle for appropriations that could result in the funding being both limited and unreliable. Some portion of user funding would result in greater and more reliable funding for the ERP over time. The underlying, legitimate need is to assure that the ERPP has sufficient funding over time.
- In order to make appropriate resource use decisions in the future leading to a sustainable Delta system, water users must consider the full costs of their actions, including their effect on the ecosystem. The sustainability concern relates to the fact

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that current water costs do not accurately reflect the full costs of water use, including ecosystem impacts. This could result in decisions over time that could undermine the objectives and success of the Program, even if the initial Program appeared to be effective. Incorporating costs of the ERP in the cost of using water from the Delta would result in a more accurate reflection of the true costs of water resource use decisions over time, resulting in decisions that would maintain or enhance the effectiveness of the Program over time. The underlying need is to incorporate the full costs of water use, including ecosystem impacts, in the price of water.

User Funding for the ERP

One key to addressing these needs without attempting to unravel the past can be found in differentiating between reparation for past acts and mitigating ongoing impacts. ERP flows can be considered as required to mitigate the ongoing impacts of water diversion and impoundment in the Bay-Delta system, and paid for with water user funds. The rationale for water user funding for ERP flows is based on the premise that natural flows would be ideal for ecosystem purposes. The only reason that the ERP flows are needed is that ongoing diversion and impoundment alter natural flows to the extent that additional flows are required at certain times to preserve ecosystem health. The cost of mitigating these ongoing impacts should be borne by all users of water in the Bay-Delta system. Instituting a charge on all Bay-Delta water use would work to satisfy both of the needs outlined above: the cost of water usage would reflect ecosystem impacts and the ERP would have additional, stable funding from water users.

CALFED supports instituting a charge on all water users in the Bay-Delta system, the proceeds of which would be used to fund the Common Programs including the ERP. Within the ERP, these water user funds would be used to pay the costs of providing the ERP flows.

Water users are not the only users that affect the system. Run-off from pesticides can be detrimental to the water quality and ecosystem of the Bay-Delta system. While large users of pesticides, such as farmers, are subject to regulation, homeowners can use pesticides without realizing the negative cumulative impacts they have on the Bay-Delta system. A surcharge on pesticides would better reflect the true cost of pesticide use, including ecosystem impacts. The funds collected would be used to help pay for the ERP and water quality programs.

Salmon fisheries also enjoy the benefits of the Delta. Over time, the effects of the ERP are expected to increase salmon populations, which is a benefit to salmon fishing interests. To capture the incremental benefit to salmon fisheries, end-user revenues from Salmon Stamps in excess of the historical amounts should be pledged to the ERP, further supplementing public funding for implementation of the program.

State and Federal funding will provide the remainder of the costs of the ERP. It will be incumbent on the assurances package to put in place sufficient measures to provide adequate ongoing funding for the ERP, as well as other aspects of the Preferred Alternative. Consistent with CALFED Solution Principles, the ERP must proceed along with improvements in the other resource areas.

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A second key to addressing the legitimate needs of environmental interests lies in ensuring that the full costs of new water development infrastructure, again including ecosystem impacts, are borne by those receiving water from the new facilities.

For purposes of Storage and Conveyance facilities, CALFED determines that the benefits-based principle means that the users of these facilities must pay the full cost of the facilities including interest.

Storage

New storage facilities have been assumed to include 1/3 of their capacity for ecosystem purposes. Water for ecosystem purposes from any new storage facilities would be used to provide ERP flows. As outlined above, providing for ERP flows is properly construed as mitigation for ongoing diversion and impoundment throughout the Delta system, and should be funded through a water user charge on usage throughout the watershed and Delta service area. The cost of mitigating these system-wide impacts should not be borne solely by those users participating in the new storage facilities, but they should pay their share of the system-wide charge based on their usage.

Water users contracting to participate in the 2/3 of the new storage from which they will receive the water must pay the full share of that portion of the new storage, including interest.

Conveyance

New conveyance facilities are defined by CALFED as providing benefits to the water users that would receive water delivered through the facilities. This means that water users contracting to receive water through any facilities must pay the full costs of the facilities, including interest.

Storage and Conveyance Planning Costs

As has been the case so far with the entire CALFED program, public funding has been used for the planning process for Storage and Conveyance facilities. This is expected to continue into Phase III of the CALFED Bay-Delta Program. The Storage and Conveyance planning must go forward along with other components of the Preferred Alternative.

In order to faithfully adhere to the principle that users must pay the full costs of new facilities, these planning costs must eventually be reimbursed, including interest, by those water users contracting to participate in the new facilities. Reimbursement should be limited to actual design costs related to development of the specific facility, once one is selected, as opposed to the entire CALFED planning process leading up to the selection of a Preferred Alternative. This is a practical decision, based on the premise that fixing overall Delta resource problems is in the public interest, and expenditure of public funds is appropriate for the planning process to do so.